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No. 239

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IN THE  
**Supreme Court of the United States**  
OCTOBER, 1946, TERM

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JOSEPH MELTZER and BERTHA MELTZER,  
Petitioners,  
v.  
COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

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**PETITION FOR A WRIT OF CERTIORARI TO THE  
UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE 2ND CIRCUIT AND BRIEF IN  
SUPPORT THEREOF**

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✓  
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IN THE  
**Supreme Court of the United States**  
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JOSEPH MELTZER and BERTHA MELTZER,  
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v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

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**PETITION FOR A WRIT OF CERTIORARI TO THE  
UNITED STATES CIRCUIT COURT OF  
APPEALS FOR THE 2ND CIRCUIT**

JOSEPH MELTZER and BERTHA MELTZER respectfully submit this petition and pray that a writ of *certiorari* issue to review the decision and mandate of the United States Circuit Court of Appeals for the 2nd Circuit which affirmed an order of the Tax Court of the United States which had "ordered and decided that there is a deficiency in the income tax for the calendar year 1941 in the amount of \$4,571.65".

**Opinions Below**

The memorandum, findings of fact and opinion of the Tax Court of the United States are dated June 20, 1945. A copy thereof is annexed and marked Appendix A.

The majority opinion of the United States Circuit Court of Appeals for the 2nd Circuit written by Circuit Judge Phillips is dated April 15, 1946. A copy thereof is annexed and marked Appendix B.

The dissenting opinion of Circuit Judge Learned Hand of the United States Circuit Court of Appeals for the 2nd Circuit is annexed and marked Appendix C.

### **Summary Statement of the Matters Involved**

This proceeding concerns a deficiency assessment against the petitioners for income taxes for the calendar year 1941.

The letter of the respondent claiming such deficiency is dated February 25, 1944. From such proposed adjustment of petitioners' tax liability, petitioners appealed to the Tax Court of the United States by petition verified April 10, 1944.

The Tax Court of the United States decided the issues in favor of the respondent. The petitioners appealed from such determination to the United States Circuit Court of Appeals, 2nd Circuit, by petition verified August 29, 1945.

The Circuit Court of Appeals affirmed the judgment of the Tax Court, Circuit Judge Learned Hand Dissenting.

### **Jurisdiction**

The mandate of the Circuit Court of Appeals for the 2nd Circuit was entered on April 15, 1946. The jurisdiction of the Supreme Court of the United States is founded on Section 347-a of the United States Judicial Code.

### **The Facts Herein**

The following are the facts of this case as found by the Tax Court:

The petitioners, husband and wife, are residents of New York City. They filed a joint income tax return for the calendar year 1941 with the Collector of Internal Revenue for the 3rd District of New York. Joseph Meltzer will hereinafter be referred to as the petitioner.

In the return petitioner claimed a deduction from gross income of \$13,000 as a bad debt. This deduction was disallowed by the respondent. Petitioner thereafter claimed that the total amount of bad debt deductions to which he is entitled is \$14,250.

The petitioner was a civil engineer with an office at 10 East 40th St., New York City. He was associated in business with Herman M. Braloff.

In 1929 Victor Mayper, a friend of petitioner, who was an architect and engineer, engaged in the designing and supervision of the construction of speculative industrial buildings and apartment houses, and who had had considerable income for a number of years from the practice of his profession, approached the petitioner for a loan of \$13,000, and offered as security a mortgage upon his residence in Douglastown, Long Island. Mayper had built this residence in 1928 at a cost of approximately \$50,000. There was at the time a first mortgage on the property of \$20,000 and a second mortgage of \$12,500, though these mortgages by 1929 may have been reduced by the amount of a few hundred dollars. The petitioner did not have the \$13,000 to lend him but thought his associate in business, Braloff might be willing to make the loan. Braloff had the money and made the loan. As security Mayper gave a personal bond to Braloff in the amount of \$13,000, a note for the same amount bearing interest, and a third mortgage upon his residence in Douglastown. The principal security of Braloff, was however, the petitioner's collateral bond in the sum of \$13,000 guaranteeing the payment of the note and mortgage.

When the time came for the payment of interest upon the note Mayper was without funds to make any payment thereon. Braloff then requested the petitioner to make good on his bond. After some negotiations between Braloff and the petitioner, Braloff accepted \$10,000 in

cash from the petitioner in satisfaction of his bond. The petitioner then became subrogated to all of Braloff's rights against Mayper. The petitioner then looked to Mayper for the payment of interest upon his note. By reason of the financial crash of 1929 and the subsequent decline in building operations, Mayper was not able to make any payment on the note. He did, however, give several notes to the petitioner for the amount of the interest which was due but unpaid.

Through his friendship for Mayper and for the purposes of tiding him over the financial depression the petitioner made additional advances to Mayper as follows:

2 months prior to August 7, 1930.....	\$ 250.
August 7, 1930. ....	1,500.
June 17, 1931 .....	500.
March 16, 1932 .....	1,000.
November 25, 1932 .....	1,000.
<hr/>	
Total .....	\$4,250.

Mayper's financial condition continuously deteriorated. He was not able to make any payments to the petitioner upon his indebtedness. In 1935 the holder of the first mortgage on Mayper's residence at Douglstown foreclosed, and the property was sold for approximately \$24,000, which was only sufficient to pay off the first mortgage and arrears in taxes. Neither the holder of the second mortgage nor the petitioner obtained deficiency judgments against Mayper.

From 1935, after the foreclosure, until 1941, the financial condition of Mayper did not improve. After 1935 Mayper had no real property and no personal property except wearing apparel of less than \$300 in value and office furniture of \$50 in value. He had no credit whatever except a limited amount from a blueprinter. From 1935 on his liabilities, including indebtedness to the petitioner, were approximately \$28,000 in excess of assets.

In June, 1937, Mayper was put through supplementary proceedings in respect to a debt of \$1,282.70. This debt was compromised by the payment of \$310 by Mayper with money which he borrowed from another party. He made this compromise settlement in order to avoid bankruptcy proceedings.

In 1940 the affairs of Mayper were poor as described by Mayper and "sad" as related by him to Joseph Meltzer.

The petitioner made many demands upon Mayper for at least installment payments upon his indebtedness to him. Mayper frankly stated that he was not in a position to make any payment until business improved.

In 1941 the petitioner made a final demand upon Mayper for the payment of his money but Mayper stated that his financial condition had not improved—that he was in no position to make payment. The petitioner threatened to obtain a judgment against Mayper for the payment of his indebtedness and Mayper told him that if he did it would simply force him into bankruptcy. He then was requested to submit to an examination by his attorney as to his financial condition. He readily submitted to such examination on December 18, 1941, and stated that besides having no assets of any material value he owed others besides petitioner approximately \$7,500 and that by reason of priorities resulting from the war situation he did not expect that his financial condition would improve to enable him ever to make any payment upon his indebtedness to the petitioner.

### Questions Presented

1. Does Section 23K (d) of the Internal Revenue Code which makes Section 23K (1) of the Revenue Act of 1942 retroactive to taxable years after December 31, 1938 mean that the deduction of debts which became worthless before

December 31, 1938 are to be allowed or disallowed under the old law or the new law?

2. Was it necessary that the Tax Court make definite findings of fact stating the year in which the debt became actually worthless and the year in which Meltzer ascertained worthlessness?

3. If the first question is answered in the affirmative,—that if the debt became worthless prior to December 31, 1938, the taxpayer is entitled to a deduction in the year in which he ascertained the debt to be worthless—does the word “ascertain” mean ascertainment by the creditor in his judgment, or does it mean that the creditor is required to determine worthlessness when he or a reasonable man ought to have done so?

4. Is Section 23K (d) of the Revenue Act of 1942 which makes Section 23K (1) retroactive to taxable years after December 31, 1938 unconstitutional because it is retroactive for longer than a reasonable period of time in view of the special circumstances surrounding the enactment of the amendments?

### **Statutes Involved**

At the time petitioner filed his return for the year 1941, bad debt deductions were controlled by the Internal Revenue Code, Section 23 (k) which provided as follows:

“Bad Debts.—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.”

Subsequently and on October 21st, 1942, Congress adopted the Revenue Act of 1942, in which the rule for the deduction of bad debts was changed as follows:

Section 124; Revenue Act of 1942:

Section 23 (k) (1)

"General rule.—Debts which become worthless within the taxable year; or (in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part which becomes worthless within the taxable year, as a deduction. This paragraph shall not apply in the case of a taxpayer, other than a bank, as defined in section 104, with respect to a debt evidenced by a security as defined in paragraph (3) of this subsection. This paragraph shall not apply in the case of a taxpayer other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection."

Section 23 (k) (4)

"Non-business debts—In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. The term 'non-business debt' means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business."

Section 23 (k) (d)

"Effective Date of Amendments—The amendments made by this section adding the last sentence of sec-

tion 23 (k) (1) and adding section 23 (k) (4) shall be effective only with respect to taxable years beginning after December 31, 1942, the amendment inserting section 23 (k) (5) and amendments related thereto shall be applicable only with respect to taxable years beginning after December 31, 1941; and the other amendments made by this section shall be effective with respect to taxable years beginning after December 31, 1938."

### **Specifications of Errors to be Urged**

The Circuit Court of Appeals erred:

1. In applying to the facts found by the Tax Court Section 23 (k) (1) of the Revenue Act of 1942 instead of Section 23 (k) as it existed prior to such amendment.
2. In failing to rule that the Tax Court erred in omitting to make findings of fact as to the year in which the debt actually became worthless and the year in which the taxpayer ascertained it to be worthless.
3. In holding that Congress had the power to make the 1942 amendment retroactive so as to apply to the taxable year 1941, and in holding such provisions constitutional.

### **Reasons relied on for the Allowance of this Writ**

The reasons certiorari should be granted in this case are as follows:

1. There is a Federal question of importance involving income tax laws not yet determined. It is necessary to settle the meaning of the retroactive clause of the 1942 amendments regarding deductions for bad debts. Shall the Treasury Department and taxpayers, in the future, be guided by the construction placed upon the statute by the

majority or minority opinion of the Circuit Court of Appeals in this case? (The case of *Cittadine v. Commissioner*, 139 Fed. (2d) 29 cited in the majority opinion is purely dicta as is shown in the accompanying brief.)

The construction given in the majority opinion of the Circuit Court of Appeals in this case offers no relief to taxpayers as was intended by Congress, but made their lot more burdensome. The House Ways and Means Committee report (#2333—77th Congress 2nd Session P. 44) shows the intention of Congress. The report states as follows:

“Under the existing law, the taxpayer may be whipsawed out of a deduction for a bad debt because of the uncertainty as to the time at which the debt becomes worthless. Later evidence often discloses that present decisions as to the year in which a debt becomes worthless are erroneous. For example, the taxpayer concludes that a debt has become bad and takes the deduction in that year, only to discover by later evidence that the debt actually became worthless 3 years previously. The statute of limitations having run on such previous year, this deduction is lost forever to the taxpayer. Conversely, where the debt actually became worthless in a year later than the year chosen by the taxpayer, the 3-year statute of limitations may operate against the Government.

To relieve this inequitable situation the bill replaces the present 3-year statute of limitations in such cases with a 7-year statute, giving a considerably greater flexibility to the allowance of bad debt deductions in the proper year.”

2. If the construction contended for by Judge Hand is the correct one it is then necessary to settle the conflict between Circuits as to the meaning and application of the word “ascertainment.” The rule in the 2nd Circuit

was last expressed in *Mayer Tank Manufacturing Co. v. Commissioner*, 126 Fed. (2) 588, 591, that the taxpayers should have the deduction in the year in which he in fact ascertained the debt to be worthless. This is commonly called the "subjective test". Other Circuits have applied the "objective test" and hold that a debt is ascertained to be worthless when the creditor or a reasonable man ought to have determined the debt to be so. This is the rule in the 3rd Circuit, *Reading v. Commissioner*, 132 Fed. (2d) 306, 309.

3. A tax statute may be declared unconstitutional if it is retroactive for an unreasonable length of time. In each case it is necessary to consider the nature of the tax and the circumstances surrounding the enactment of the law. *Welsh v. Henry*, 305 U. S. 134. The circumstances under which the above mentioned 1942 amendments were adopted differ, so far as we have been able to find, from the facts in all other reported decisions involving retroactive tax laws in that the law now in issue was intended to relieve taxpayers from the inequities of a prior law. It is an anomalous tax law in that it was intended to operate retroactively for the relief of taxpayers.

### **The Importance of a Review of the Questions Herein Involved**

The decision of this case is one of general applicability. Judge Hand's forceful argument that the 1942 amendments were not intended to apply to a debt which became worthless prior to December 31, 1938 was not answered by the majority. They pointed to no reason why his construction is untenable. It is important for the Government and taxpayers to know whether they are to be guided by the opinion of the majority or by Judge Hand's dissent. This case presents the question of law squarely without any involvement in questions of fact.

**Conclusion**

For the reasons stated it is respectfully submitted that the writ of certiorari prayed for herein should be granted to the end that the mandate of the United States Circuit Court of Appeals, 2nd Circuit, herein may be reviewed and reversed, and for such other and further relief as may be just and proper.

June 27<sup>th</sup>, 1946.

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**Appendix A.****MEMORANDUM FINDINGS OF FACT AND OPINION  
THE TAX COURT OF THE UNITED STATES**

---

**[SAME TITLE]**

---

MORTIMER DEGROOT, Esq., for the petitioners.

WILLIAM F. EVANS, Esq., for the respondent.

SMITH, Judge: This proceeding is for the redetermination of a deficiency in income tax for the calendar year 1941 in the amount of \$4,571.65. The petitioners allege that the respondent erred in the determination of the deficiency by disallowing the deduction from gross income of \$14,250 bad debts.

**FINDINGS OF FACT.**

The petitioners, husband and wife, are residents of New York City. They filed a joint income tax return for the calendar year 1941 with the collector of internal revenue for the third district of New York. Joseph Meltzer will hereinafter be referred to as the petitioner.

In the joint income tax return for 1941 the petitioner claimed the deduction from gross income of \$13,000 as a bad debt. This deduction was disallowed by the respondent in the determination of the deficiency. Petitioner now alleges that the total amount of bad debts to which he is entitled as a deduction is in the amount of \$14,250.

The petitioner is a civil engineer with an office at 10 East 40th St., New York City. He is associated in business with Herman M. Braloff.

*Appendix A.*

In 1929 Victor Mayer, a friend of petitioner, who was engaged in the designing and supervision of the construction of speculative industrial buildings and apartment houses, and who had had considerable income for a number of years from the practice of his profession, approached the petitioner for a loan of \$13,000. He stated that he would give a mortgage upon his residence in Douglastown, Long Island, as security for the loan. Mayer had built this residence in 1928 at a cost of approximately \$50,000. There was at the time a first mortgage on the property of \$20,000 and a second mortgage of \$12,500, though these mortgages by 1929 may have been curtailed by the amount of a few hundred dollars. The petitioner did not have the \$13,000 to loan him but thought his associate in business, Braloff might be willing to make the loan. Braloff had the money and made the loan. As security for the loan Mayer gave a personal bond to Braloff in the amount of \$13,000, a note for the same amount bearing interest, and a third mortgage upon his residence in Douglastown. The principal security of Braloff was, however, the petitioner's bond in the sum of \$13,000 guaranteeing the payment of the note and mortgage pursuant to its terms.

When the time came for the payment of interest upon the note Mayer was without funds to make any payment thereon. Braloff then requested the petitioner to make good on his bond. After some negotiations between Braloff and the petitioner, Braloff accepted \$10,000 in cash from the petitioner in satisfaction of his bond. The petitioner then became subrogated to all of Braloff's rights in respect of the loan which he had made to Mayer. The petitioner then looked to Mayer for the payment of interest upon his note. By reason of the financial crash of 1929 and the subsequent decline in building operations, Mayer was not able to make any payment

*Appendix A.*

on the note. He did, however, give several notes to the petitioner for the amount of the interest which was due but unpaid.

Through his friendship for Mayper and for the purpose of tiding him over the financial depression the petitioner made additional advances to Mayper as follows:

2 months prior to August 7, 1930 .....	\$ 250
August 7, 1930 .....	1,500
June 17, 1931 .....	500
March 16, 1932 .....	1,000
November 25, 1932 .....	1,000

Mayper's financial condition continuously deteriorated. He was not able to make any payments to the petitioner upon his indebtedness to him. In 1935 the holder of the first mortgage on Mayper's residence at Douglaston foreclosed the first mortgage on the property, which was sold at a price of approximately \$24,000, which was only sufficient to pay off the first mortgage and arrears in taxes. Neither the holder of the second mortgage nor the petitioner obtained deficiency judgments against Mayper.

From 1935, after the foreclosure, until 1941, the financial condition of Mayper did not improve. After 1935 Mayper had no real property and no personal property except wearing apparel of less than \$300 in value and office furniture of \$50 in value. He had no credit whatever except a limited amount from a blueprinter. From 1935 on his liabilities, including indebtedness to the petitioner, were approximately \$28,000 in excess of assets.

In June, 1937, Mayper was put through supplementary proceedings in respect of a debt of \$1,282.70. This debt was compromised by the payment of \$310 by Mayper with

*Appendix A.*

money which he borrowed from another party. He made this compromise settlement in order to avoid bankruptcy proceedings.

In 1940 the affairs of Mayper were poor as described by Mayper and "sad" as related by him to Joseph Meltzer.

The petitioner made many demands upon Mayper for at least installment payments upon his indebtedness to him. Mayper frankly stated that he was not in a position to make any payment until business improved.

In 1941 the petitioner made a final demand upon Mayper for the payment of his money but Mayper stated that his financial condition had not improved—that he was in no position to make payment. The petitioner threatened to obtain a judgment against Mayper for the payment of his indebtedness and Mayper told him that if he did it would simply force him into bankruptcy. He then was requested to submit to an examination by his attorney as to his financial condition. He readily submitted to such examination on December 18, 1941, and stated that besides having no assets of any material value he owed others besides petitioner approximately \$7,500 and that by reason of priorities resulting from the war situation he did not expect that his financial condition would improve to enable him ever to make any payment upon his indebtedness to the petitioner. Upon the basis of these facts the petitioner claimed the deduction from his gross income for 1941 of the \$13,000 which was disallowed by the respondent in the determination of the deficiency.

The debt owed by Victor Mayper to the petitioner in the amount of \$14,500 became worthless prior to 1941.

*Appendix A.*

## OPINION.

The only question presented by this proceeding is whether the debt owed by Victor Mayper to the petitioner in the amount of \$14,250 became worthless in 1941.

Section 23 (k) of the Internal Revenue Code, as amended by section 124 (a) of the Revenue Act of 1942, permits the deduction from gross income of "Debts which become worthless within the taxable year." Prior to that time that section of the Code permitted the deduction from gross income of "Debts ascertained to be worthless and charged off within the taxable year." The amendment was made effective "with respect to taxable years beginning after December 31, 1938." See section 124 (d) of the Revenue Act of 1942.

In *Harris v. Commissioner* (C. C. A., 2nd Cir.), 140 Fed. (2d) 809, the court had before it the question as to whether a debt claimed to have been ascertained to be worthless and charged off in 1936 was a legal deduction from the gross income of that year. In its opinion the court said:

\* \* \* There is no doubt, nor is any claim to the contrary here made that as the law then stood the petitioner was bound to make the charge-off in the year in which he first ascertained the debt to be worthless \* \* \* In our view the "subjective test" is the right one, and the proper year to make the charge-off is that in which the taxpayer actually makes the determination of worthlessness. *Rosenthal v. Helvering* (2 Cir.) 124 Fed. (2d) 474; *Curry v. Commissioner* (2 Cir.) 117 Fed. (2d) 307. \* \* \*

We think it quite clear that the question before us in this proceeding is not when the debt of Mayper to the

*Appendix A.*

petitioner was ascertained by the petitioner to be worthless and charged off, but rather the objective test as to when it actually became worthless.

The petitioner contends that it actually became worthless in 1941; that up until then he had hopes of ultimately collecting his debt from Mayper, because Mayper had been successful in his profession prior to 1930 and because there was a probability that he would again regain financial ability to pay his debts. He also argues that the entrance of the United States into war with Germany and Japan in December, 1941, was an identifiable event which made the debt worthless in 1941.

We do not think that the petitioner's contention has a realistic basis. By 1935 Mayper had lost all his property and was indebted to others besides the petitioner. He appears never to have been able to make more than his living expenses after 1935. On cross examination Mayper testified as follows:

Q. Now, at the time in 1941 in which you made an affidavit or statement to counsel of petitioner, you say you are indebted to him in the sum of \$5,370 and then the further sum of \$13,000; and you had no means or income to pay that indebtedness or any part of it; that would be true ever since 1935, would it not?

A. Yes.

Q. You say, then, that you have no personal property or any interest therein, and that condition has been true since 1935, has it not?

A. Yes.

Q. You say you have no personal property other than wearing apparel of the value of less than \$300, and office furniture of the value of not exceeding \$50;

*Appendix A.*

I will ask you if that position has not obtained since 1935 with reference to your affairs?

A. I would say so, yes.

It seems to us that the evidence clearly shows that Mayer's debt to the petitioner became worthless long prior to 1941 and that there was no happening in 1941 which made the debt worthless in that year.

In our opinion the respondent properly denied the deduction of the claimed debt from the petitioner's gross income for 1941.

Decision will be entered for the respondent.

ENTER:

Entered June 20 1945

(Seal)

**Appendix B.**

**UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE SECOND CIRCUIT**

No. 168—October Term, 1945.

(Argued March 7, 1946                      Decided April 15, 1946.)

Docket No. 20052

---

JOSEPH MELTZER and BERTHA MELTZER,  
*Petitioners,*

*v.*

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent.*

---

Before:

L. HAND, SWAN and PHILLIPS,  
*Circuit Judges.*

On Petition to Review the Decision of the Tax Court of  
the United States.

HARRY J. STEIN, *for petitioners.*

S. DEE HANSON, Acting Asst. Atty. Gen. (SEW-  
ALL KEY and HELEN R. CARLOSS, *Sp. Assts.*  
*to the Atty. Gen.*, were with him on the  
brief) *for respondent.*

PHILLIPS, *Circuit Judge*, delivered the opinion of the  
court.

This is a petition to review a decision of the Tax Court.

*Appendix B.*

Petitioners Joseph Meltzer<sup>1</sup> and Bertha Meltzer, husband and wife, filed a joint tax return for 1941, in which they claimed a deduction of \$13,000 as a bad debt.

Sec. 23 of the Revenue Act of 1942 provides:

“In computing net income there shall be allowed as deductions: \* \* \*

“(k) (1) debts which become worthless within the taxable year.”

The amendment was approved October 21, 1942, and by its terms was retroactive so as to include the year 1941.

Mayper, the debtor, was a designer and a supervisor of construction of industrial buildings and apartment houses. In 1928, he built a residence at a cost of \$50,000. It was encumbered by a first mortgage of \$20,000 and a second mortgage of \$12,500. Mayper obtained a loan of \$13,000 from one Braloff. Mayper gave Braloff a personal bond and a note, bearing interest, each for the sum of \$13,000, and a third mortgage upon the house to secure the note and bond. Meltzer gave Braloff a collateral bond for \$13,000 to guarantee the loan. Mayper defaulted in the payment of interest, and Braloff made demand on Meltzer for payment of the indebtedness under the guarantee. After some negotiations, Braloff accepted \$10,000 from Meltzer, in satisfaction of his bond, and assigned Mayper's bond, note, and mortgage to Meltzer. By reason of the financial depression in 1929 and subsequent years, and the decline in building operations, Mayper was not able to make any payments on the note. He gave several notes to Meltzer for accrued interest. Through his friendship with Mayper, and for the purpose of tiding Mayper over the financial depression, Meltzer made advances to Mayper in the years 1930, 1931,

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<sup>1</sup> Hereinafter referred to as Meltzer.

*Appendix B.*

and 1932, aggregating \$4,250. Mayper's financial condition deteriorated progressively. Meltzer made demands upon Mayper from time to time for payments on the indebtedness, without avail. In 1935, the first mortgagee foreclosed his mortgage. At the foreclosure sale, it sold for an amount sufficient only to pay the first mortgage indebtedness and arrears in taxes. Neither the holder of the second mortgage nor Meltzer obtained deficiency judgments against Mayper. From 1935 to 1941, Mayper's financial condition did not improve. By 1935, he was without property except wearing apparel and office furniture. From 1935 on, his liabilities were approximately \$28,000 in excess of his assets.

The Tax Court found that the debt did not become worthless in the taxable year 1941.

Petitioners contend that it was not until the advent of the war, and the virtual suspension of the construction of building of a nondefense nature, and the resulting inability of Mayper to obtain employment, that the debt became worthless.

A finding of fact made by the Tax Court, if supported by substantial evidence, is conclusive.<sup>2</sup> We are of the opinion that the facts, with respect to Mayper's financial condition from 1935 to 1940, fully warranted the Tax Court in finding that the debt did not become worthless in 1941.

Since deductions are a matter of legislative grace,<sup>3</sup> we think there can be no doubt of the power of Congress to make the 1942 amendment retroactive so as to apply to the taxable year 1941.<sup>4</sup>

Affirmed.

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<sup>2</sup> *Hekvering, Commissioner v. Kehoe*, 309 U. S. 277, 279.

<sup>3</sup> *Antietam Hotel Corporation v. Commissioner*, 4 Cir., 123 F. 2d 274, 278.

<sup>4</sup> *Cittadine v. Commissioner*, 4 Cir., 139 F. 2d 29, 31; *Milliken v. United States*, 283 U. S. 15, 21.

### Appendix C.

L. HAND, *Circuit Judge* (dissenting):

I agree that we must accept the finding of the Tax Court that the debt did not become worthless in 1941; but that court did not find whether it became worthless before or after December 31, 1938. The amendment to § 23(k)(1) in 1942 was made retroactive to December 31, 1938—§ 23(k)-(d)—and that, I submit, meant that the deduction of debts becoming worthless before then was to be determined under the old law. If so, debts, although they had actually become worthless before December 31, 1938, were to be deducted in the year in which the creditor "ascertained" that they became worthless. We have ruled a number of times—last in *Mayer Tank Manufacturing Co. v. Commissioner*, 126 Fed. (2) 588, 591—that the year in which a debt is "ascertained" to be worthless is that in which the creditor in fact "ascertained" it to be so, and not that in which he ought to have done so, or which a reasonable man would have done so. Other circuits have held the contrary—e. g. *Reading Co. v. Commissioner*, 132 Fed. (2) 306, 309 (C. C. A. 3)—but I assume that we should follow our own precedents. The Tax Court made no finding whether the taxpayer first "ascertained" the debt to be worthless in 1941, although I believe that there was adequate basis for a finding that it was in that year. For the foregoing reasons I regard findings necessary upon the following questions: (1.) Did the debt become worthless before December 31, 1938? (2.) Did the taxpayer in fact "ascertain" before 1941 that it had become worthless?

I submit that this interpretation is the only one consistent with the purpose of the amendment, if, as I understand to have been the case, it was intended to relieve creditors. As the law was, they were in a difficult position, because they had to prove, not only that the debt had become worthless, but that the year in which they claimed

*Appendix C.*

the deduction was the first in which they had "ascertained" that it had become so; and the last in particular was often extremely troublesome. It is true that the present law imposes upon them the risk of learning when the debt does become worthless, but in that it does no more than in the case of other losses. My brothers are now deciding that, if a creditor failed to claim deduction for a debt which actually became worthless before 1939, he may never deduct it, although he was under no duty to "ascertain" its worthlessness in that year, the statute having assured him that he need not claim it until he in fact did "ascertain" it. The amendment therefore increased, instead of lightened, the burden of such taxpayers, and in effect took away their privilege altogether. True, creditors whose debts became worthless in 1939, 1940, 1941, were at their peril bound to claim the deduction for those years, and it might appear that they were as much shut out as those whose debts became worthless earlier; but this is untrue, for in 1942 such creditors still had time to claim a refund for those years (§ 169(a)(2) of the Act of 1942). To confine the retroactivity of the amendment to debts becoming worthless after 1938, is, therefore, I submit, not only consistent with the text, but with the demands of justice.

Finally, I think that the question is open to us upon this appeal. I should suppose that a question of law emerges with enough distinctness from any questions of fact in which it is enmeshed, to require an answer; and that that question was also one of general applicability. Indeed, it would seem that our jurisdiction must extend so far, if we are to have any whatever.

IN THE  
**Supreme Court of the United States**

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JOSEPH MELTZER and BERTHA MELTZER,  
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

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**PETITIONERS' BRIEF**

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**The Facts**

The facts will be found on pages 2 to 5 of the petition.

**Statutes Involved**

The statutes involved are set forth on pages 6 and 7 of the petition. They may be tersely summarized as follows:

On October 21, 1942 Section 23 (k) (1) of the Internal Revenue Code was adopted. It provided that in computing net income there shall be allowed as deductions debts which became worthless within the taxable year.

Section 23 (k) (d) of the same Act provided that the said amendment shall be retroactive to taxable years beginning after December 31, 1938.

Prior to the said amendments Section 23 (k) of the Internal Revenue Code provided that there shall be allowed as deductions debts ascertained to be worthless and charged off within the taxable year.

### **Specifications of Errors**

The Specifications of Errors are set forth on page 8 of the petition.

### **Argument**

This appeal brings to the Supreme Court a case involving a question of income tax law of considerable importance which has not been previously decided, and one in which there has been a forceful dissenting opinion. The question is one of general application.

Should the Supreme Court decide that the law should be construed as contended by Judge Hand in his dissenting opinion, it will also be necessary to decide an issue on which there is a conflict between circuits—Shall the “subjective test” or the “objective test” be applied in deciding when the taxpayer ascertained a debt to be worthless?

To determine the intention of Congress, the history of the amendments is material. Prior to 1942 there was considerable confusion in income tax practice over the question of when a debt was ascertained to be worthless. Taxpayers and Internal Revenue Agents frequently disagreed and many injustices resulted. There was even a conflict of opinion in the Circuit Courts. The law in the 2nd Circuit is that a debt is ascertained to be worthless in the year in which the creditor in fact determined it to be so. (*Mayer Tank Co. v. Commissioner*, 126 Fed. (2) 588). In the 3rd Circuit it is held that a debt is ascer-

tained to be worthless in the year in which the taxpayer or a reasonable man ought to have determined it to be worthless (*Reading v. Commissioner*, 137 Fed. (2) 306).

In submitting the 1942 amendments the House Ways and Means Committee recognized the existing uncertainties and injustices. The intention of Congress is stated in their report (House of Representatives Report #2333, 77th Congress 2nd Session) at page 44 as follows:

"Under the existing law, the taxpayer may be whipsawed out of a deduction for a bad debt because of the uncertainty as to the time at which the debt becomes worthless. Later evidence often discloses that present decisions as to the year in which a debt becomes worthless are erroneous. For example, the taxpayer concludes that a debt has become bad and takes the deduction in that year, only to discover by later evidence that the debt actually became worthless 3 years previously. The statute of limitations having run on such previous year, this deduction is lost forever to the taxpayer. Conversely, where the debt actually became worthless in a year later than the year chosen by the taxpayer, the 3-year statute of limitations may operate against the Government.

To relieve this inequitable situation the bill replaces the present 3-year statute of limitations in such cases with a 7-year statute, giving a considerably greater flexibility to the allowance of bad debt deductions in the proper year."

The statute should therefore be construed with that expressed intention in mind. Judge Hand, in his dissenting opinion in this case, stated that in view of the intention of Congress the retroactivity of the amendments should not apply to debts which became worthless prior to December 31, 1938 and in such event the taxpayer should be permitted to take his deduction under the old law in the year in which he ascertained worthlessness.

The application of this construction requires findings of fact as to the year in which the debt actually became worthless and the year in which the taxpayer ascertained worthlessness.

The petitioners also claim that if Judge Hand's contention is not adopted by the Supreme Court, the retroactive provisions of the law should be declared unconstitutional. The rule for the determination of the constitutionality of retroactive tax laws is set forth in *Welsh v. Henry*, 305 U. S. 134 wherein the Court stated:

"In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it is said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation."

We do not cite any other decisions because the facts with respect to the 1942 amendments are anomalous and we could find no case in point. It cannot be contradicted that the 1942 amendments were intended to relieve taxpayers from the inequities of the prior law. If the new law, intended as a reform, has the effect of making the taxpayers' burden more oppressive than it was under the inequities of the old law, then we urge that under the doctrine of *Welsh v. Henry* (supra), its retroactive application is "so harsh and oppressive that it transgresses the constitutional limitation." The harshness of retroactivity in this case is that, it having been found that the debt did not become worthless in 1941, petitioners are also being deprived of the deduction on the basis of ascertainment.

. . . . .

In the Circuit Court of Appeals the petitioners argued that upon the facts found by the Tax Court it should have concluded that the debt became worthless in 1941 and that it was also properly ascertained to be worthless in 1941. The three Judges of the Circuit Court, however, refused

to disturb the conclusions of the Tax Court. On this appeal the petitioners abandon their claim that upon the facts found the Tax Court should have reached a different conclusion. Petitioners did, however, urge in the Circuit Court that the Tax Court erred in applying to the facts Section 23 (k) (1) of the Revenue Act of 1942 instead of Section 23 (k) of the old law (Transcript, fol. 63). The question of law is squarely presented for decision here without any involvement in questions of fact.

The majority opinion cited in the case of *Cittadine v. Commissioner*, 139 Fed. (2) 29, 31. That case, however, is not binding as precedent. The Court distinctly stated that it was not necessary to rule on the constitutionality of the 1942 amendment because the taxpayer, upon the facts presented, was not entitled to the deduction under the old law or the new law.

### Conclusion

For these reasons it is respectfully submitted that the writ of certiorari prayed for herein should be granted.

Respectfully submitted,

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# **In the Supreme Court of the United States**

OCTOBER TERM, 1946

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No. 239

JOSEPH MELTZER AND BERTHA MELTZER,  
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE SECOND  
CIRCUIT*

---

**BRIEF FOR THE RESPONDENT IN OPPOSITION**

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## **OPINIONS BELOW**

The memorandum opinion of the Tax Court of the United States (R. 10-15) is not reported. The opinion and the dissenting opinion of the Circuit Court of Appeals (R. 54-57) are reported at 154 F.2d 776.

## **JURISDICTION**

The judgment of the Circuit Court of Appeals was entered April 15, 1946. (R. 58.) The petition for a writ of certiorari was filed on June 28, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

**QUESTION PRESENTED**

The taxpayer before 1941 made good his guaranty to another of a debt of \$13,000 and in turn had a claim, through subrogation, against the principal debtor who by 1935 had lost all his property, was indebted to others, had substantially no credit, and was never able to make more than his living expenses since that time. The Tax Court found that the debt became worthless prior to 1941.

The question is whether Section 23 (k) (1) of the Internal Revenue Code, as retrospectively amended by Section 124 of the Revenue Act of 1942, prohibits the allowance of a deduction for the debt in 1941; and if so, whether the statute is unconstitutional.

**STATUTES AND OTHER AUTHORITIES INVOLVED**

The statutes and other authorities involved will be found in the Appendix, *infra*, pp. 16-19.

**STATEMENT**

The pertinent facts as found by the Tax Court (R. 10-13) may be summarized as follows:

The taxpayers, husband and wife, residents of New York City, filed a joint income tax return for the calendar year 1941 with the Collector of Internal Revenue for the Third District of New York. In the return, the taxpayer claimed a deduction from gross income of \$13,000 as a bad debt which was disallowed by the Commissioner

in the determination of the deficiency. The taxpayer alleged before the Tax Court that the total amount of bad debts to which he was entitled as a deduction is \$14,250. (R. 10.)

The taxpayer is a civil engineer with an office at 10 East 40th Street, New York City. He is associated in business with Herman M. Braloff. (R. 10.)

In 1929 Victor Mayper, a friend of the taxpayer, who was engaged in the designing and supervision of the construction of speculative industrial buildings and apartment houses, and who had had considerable income for a number of years from the practice of his profession, approached the taxpayer for a loan of \$13,000. He stated that he would give a mortgage upon his residence in Douglaston, Long Island, as security for the loan. Mayper had built this residence in 1928 at a cost of approximately \$50,000. There was at the time a first mortgage on the property of \$20,000 and a second mortgage of \$12,500, though these mortgages by 1929 may have been curtailed by the amount of a few hundred dollars. The taxpayer did not have the \$13,000 to lend him but thought his associate in business, Braloff, might be willing to make the loan. Braloff had the money and made the loan. As security for the loan Mayper gave a personal bond to Braloff in the amount of \$13,000, a note for the same amount bearing interest, and a third mortgage

upon his residence in Douglaston. The principal security of Braloff was, however, the taxpayer's bond in the sum of \$13,000 guaranteeing the payment of the note and mortgage pursuant to its terms. (R. 10-11.)

When the time came for the payment of interest upon the note, Mayper was without funds to make any payment thereon. Braloff then requested the taxpayer to make good on his bond. After some negotiations between Braloff and the taxpayer, Braloff accepted \$10,000 in cash from the taxpayer in satisfaction of his bond. The taxpayer then became subrogated to all of Braloff's rights in respect of the loan which he had made to Mayper, and in consequence then looked to Mayper for the payment of interest upon his note. By reason of the financial crash of 1929 and the subsequent decline in building operations, Mayper was not able to make any payment on the note. He did, however, give several notes to the taxpayer for the amount of the interest which was due but unpaid. (R. 11.)

Through his friendship for Mayper and for the purpose of tiding him over the financial depression, the taxpayer made additional advances to Mayper during the period from June 7, 1930, to November 25, 1932, in the aggregate sum of \$4,250. (R. 12.)

Mayper's financial condition continuously deteriorated. He was not able to make any pay-

ments to the taxpayer upon his indebtedness to him. In 1935 the holder of the first mortgage on Mayper's residence at Douglaston foreclosed the first mortgage on the property, which was sold at a price of approximately \$24,000. That amount was sufficient to pay off only the first mortgage and the arrears in taxes. Neither the holder of the second mortgage nor the taxpayer obtained deficiency judgments against Mayper. (R. 12.)

From 1935, after the foreclosure, until 1941, the financial condition of Mayper did not improve. After 1935 Mayper had no real property and no personal property except wearing apparel of less than \$300 in value and office furniture of \$50 in value. He had no credit whatever except a limited amount from a blueprinter. From 1935 on, his liabilities, including indebtedness to the taxpayer, were approximately \$28,000 in excess of assets. (R. 12.)

In June, 1937, Mayper was put through supplementary proceedings in respect of a debt of \$1,282.70. This debt was compromised by the payment of \$310 by Mayper with money which he borrowed from another party. He made this compromise settlement in order to avoid bankruptcy proceedings. (R. 12.)

In 1940 the affairs of Mayper were poor as described by Mayper, and "sad" as related by him to the taxpayer, Joseph Meltzer. (R. 12.)

The taxpayer made many demands upon Mayper for at least installment payments upon his indebtedness to him. Mayper frankly stated that he was not in a position to make any payment until business improved. (R. 13.)

In 1941 the taxpayer made a final demand upon Mayper for the payment of his money, but Mayper stated that his financial condition had not improved—that he was in no position to make payment. The taxpayer threatened to obtain a judgment against Mayper for the payment of his indebtedness, and Mayper told him that if he did it would simply force him into bankruptcy. He then was requested to submit to an examination by the taxpayer's attorney as to his financial condition. He readily submitted to such examination on December 18, 1941, and stated that besides having no assets of any material value, he owed others than the taxpayer approximately \$7,500, and that by reason of priorities resulting from the war situation he did not expect that his financial condition would improve to enable him ever to make any payment upon his indebtedness to the taxpayer. Upon the basis of these facts the taxpayer claimed the deduction from his gross income for 1941 of the \$13,000 which was disallowed by the Commissioner in the determination of the deficiency. (R. 13.)

The Tax Court found as an ultimate fact that the debt owed by Victor Mayper to the taxpayer

in the aggregate amount of \$14,500<sup>1</sup> became worthless prior to 1941. (R. 13.)

Upon the basis of the foregoing facts the Tax Court, affirming the Commissioner's determination (R. 5-8), disallowed the claimed deduction for the bad debts in question on the ground that they became worthless prior to the taxable year 1941 (R. 13-15). Upon the taxpayer's petition for review (R. 17), the Circuit Court of Appeals—one judge dissenting—affirmed (R. 54-57).

#### ARGUMENT

There is no conflict of decisions, the decision of the court below is clearly correct and review by this Court is not required.

1. Section 124 (a) of the Revenue Act of 1942 amended Section 23 (k) (1) of the Internal Revenue Code to provide for a deduction of "debts which become worthless during the taxable year" in lieu of the former deduction of "debts ascertained to be worthless and charged off within the taxable year"; see Appendix, *infra*, p. 16. Section 124 (d) plainly provides that this amend-

<sup>1</sup> This amount comprises the sum of \$10,000 cash which the taxpayer's partner Braloff accepted from the taxpayer in satisfaction of his bond guaranteeing payment of Mayer's note and mortgage (R. 11), plus the additional advances aggregating \$4,250 which the taxpayer made from June 7, 1930, to November 25, 1932, to tide Mayer over the financial depression (R. 12). The taxpayer claimed a deduction of only \$13,000 in his return with respect to Mayer's debt, but before the Tax Court he claimed a total deduction of \$14,250. (R. 10.)

ment is effective with respect to taxable years beginning after December 31, 1938. The court below properly held that under this statute the taxpayer was entitled to the deduction claimed for 1941 only if the debt became worthless in 1941, and that the Tax Court's finding that the debt became worthless prior to 1941, which was supported by substantial evidence, is conclusive on review. *Wilmington Co. v. Helvering*, 316 U. S. 164.

The taxpayer does not contend in this Court that the Tax Court's finding should be set aside. His sole contention is that the statute should be construed as the dissenting judge construed it, namely, that if the debt became worthless prior to 1939, it may still be deducted in the year it is later ascertained to be worthless under the law as it stood prior to the amendment and that the Tax Court should have found that it was first "ascertained" to be worthless in 1941, since ascertainment of worthlessness calls for a subjective rather than an objective test.

There is, however, no basis for this construction of the statute. Section 124 states in plain terms that it applies to "taxable years beginning after December 31, 1938." The taxable year here involved is 1941, and the law as amended is to be applied to all deductions for bad debts taken in that year. No exception is made as to debts which became worthless prior to 1939 but which were thereafter ascertained to be worthless. Other Circuit

Courts of Appeals have held that the statute is to be applied retroactively to all tax years beginning after 1938. *Cittadini v. Commissioner*, 139 F. 2d 29 (C. C. A. 4); *Fitzgerald v. Commissioner*, 154 F. 2d 1017 (C. C. A. 6), petition for a writ of certiorari pending, No. 245, this Term; *Redman v. Commissioner*, 155 F. 2d 319 (C. C. A. 1). In the *Cittadini* case, the court rejected the contention that there should be made an exception such as the taxpayer contends for in this case.

The taxpayer's contention that the legislative history shows that Congress did not intend the 1942 amendment to prohibit a deduction where to do so would impose a hardship such as would be imposed here (Br. 25-26) is not well taken.<sup>2</sup> Section 124 of the 1942 Act is so plain and unambiguous that there is no reason to turn to the Committee Reports or to other provisions of the law for interpretation. *Hecht v. Malley*, 265 U. S. 144, 151-152, 153. Even if these were examined, there is nothing in either to show or indicate that the lower court's interpretation and application of Section 124 herein is incorrect. If resort need be had to the Committee Reports,

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<sup>2</sup> The taxpayer has not actually established any hardship. The record does not compel an inference that the debt was not ascertained to be worthless until 1941. While the Tax Court did not find to the contrary, since a finding as to that was not required, the evidence would clearly justify a finding that it was ascertained to be worthless before 1941. Ascertainment of worthlessness is not a purely subjective matter. See *Boehm v. Commissioner*, 326 U. S. 287.

however, the legislative history shows that "the fact of worthlessness, which is the proper criterion, will prevail."<sup>3</sup> It also shows that while ascertainment of worthlessness and charge-off on a taxpayer's books during the taxable year were prerequisite to the allowance of deductions for bad debts under the old law (H. Rep. No. 2333, 77th Cong., 2d Sess., p. 76 (Appendix, *infra*, p. 19).

this section [of the 1942 Act] amends section 23 (k) of the Code [requiring ascertainment and charge-off] to allow a deduction for a debt which becomes worthless during the taxable year *regardless of the year in which the debt is ascertained to be worthless* or charged off. [Italics supplied.]

The 1942 retroactive amendment is clearly applicable to 1941 returns. The taxpayer's argument (Br. 26-28), based on the dissenting opinion below, is unsound and, if given effect, would make the amendatory provision meaningless. Quite clearly, if Congress had intended to except any debt deductions from the express terms thereof or to treat some of them differently, it would have placed such a limitation in Section 124. The amendment in that section was designed to remove the then existing inequities in

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<sup>3</sup> This is in harmony with this Court's holding in *Boehm v. Commissioner*, *supra*, 326 U. S. at 292, that "a loss, to be deductible \* \* \* must have been sustained *in fact* during the taxable year." [Italics in original.]

the old law, particularly with respect to the uncertainties as to the time when debts became deductible. Congress accomplished this by substituting the test of "debts which become worthless within the taxable year" for the former requirement of "debts ascertained to be worthless and charged off," and by retroactively extending the limitation period on assessments and refunds to seven years. H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 44-45, par. 3 (A) and (B) (Appendix, *infra*, pp. 18-19). Obviously Congress could have extended the period retroactively for a much greater length of time but presumably it considered that any further extension would have been inadvisable from an administrative standpoint lest it upset many matters already settled and closed. Consequently, realizing that the needs of *all* taxpayers could not be met and that the limitation must be reasonably fixed, Congress deemed it advisable to make the amendment applicable only to taxable years beginning after December 31, 1938, and to extend the statute of limitations to seven years. Sections 124 (d) and 169 of the Revenue Act of 1942. This was fair to both the taxpayers and the Government.

2. The majority opinion of the court below properly held that since deductions are a matter of legislative grace there can be no doubt of the power of Congress to have made the 1942 amendment effective retroactively so as to apply to the taxable year 1941. (R. 56.)

The taxpayer argues that if the position set forth in the dissenting opinion below is not adopted by this Court, the provisions of the 1942 Act applying retrospectively to all taxable years after 1938 should be declared unconstitutional as being retroactive for an unreasonable length of time and harshly and oppressively depriving him of relief from the inequities of the prior law intended by Congress to have been remedied by the new law. (Pet. 8; Br. 26-28.)

In the first place, it is questionable whether any hardship has been imposed on the taxpayer by the change in the law. In any event, there is clearly no merit to these contentions. In plain terms, Section 124 (d) of the 1942 Act (Appendix, *infra*, p. 16) made the amendment applicable to all years subsequent to 1938, but in this case the period of retroactivity provided thereby extended back only approximately seven months to the time when the taxpayer's 1941 return was due to have been filed on March 15, 1942. The taxpayer filed his appeal with the Tax Court on April 13, 1944 (R. 1, 3), long after the enactment of the 1942 Act. He acquired no complete right to the deduction claimed under Section 23 (k) of the old law merely by filing his return before the passage of the 1942 Act. A taxpayer has no vested right to a deduction not allowed by law (*Cittadini v. Commissioner*, 139 F. 2d 29, 31 (C. C. A. 4)), and a suit is determined by the law in effect when judgment is rendered (*United States v.*

*Heinszen & Co.*, 206 U. S. 370, 387, and authorities there cited).

Moreover, before the taxpayer's return was filed, hearings had been started on the prospective Revenue Bill of 1942 on March 3, 1942, when an elaborate statement was submitted by the then Secretary of the Treasury outlining the various provisions proposed to be enacted in the 1942 Act.<sup>4</sup> The hearings were thereafter continued before the appropriate House and Senate Committees until the Committee and Conference Reports were completed and the Bill was enacted into law on October 21, 1942, long before the Tax Court entered its decision herein on June 20, 1945. (R. 16.) Consequently, the taxpayer was put on notice "while the [1942] statute was in process of enactment" (*United States v. Hudson*, 299 U. S. 498, 500), and the amended law was in effect and therefore controlled the decision of the Tax Court when it was handed down. Accordingly, considering the circumstances herein, it cannot be said that the period of retroactivity fixed in the 1942 Act is unreasonable or that the Act's "retroactive application is so harsh and oppressive as to transgress the constitutional limitation" (*Welch v. Henry*, 305 U. S. 134, 147). Judicial approval has already been given to the retroactive application of the amendment as provided by Section 124 (d) of the 1942 Act. *Citta-*

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<sup>4</sup> House Hearings on the Revenue Revision of 1942 before the Ways and Means Committee, March 3, 1942, Vol. 1, p. 2.

*dini v. Commissioner*, 139 F. 2d 29, 31 (C. C. A. 4); *Fitzgerald v. Commissioner*, *supra*.

It is settled that reasonable retroactivity of the Revenue Acts is valid. *Milliken v. United States*, 283 U. S. 15, 23; *Cooper v. United States*, 280 U. S. 409; *Brushaber v. Union Pac. R. R.*, 240 U. S. 1; *Hecht v. Malley*, 265 U. S. 144; *Wilgard Realty Co. v. Commissioner*, 127 F. 2d 514 (C. C. A. 2), certiorari denied, 317 U. S. 655. They may properly be applied retrospectively when that purpose plainly appears, as herein. *Brewster v. Gage*, 280 U. S. 327, 337. This Court has never held a federal income tax statute invalid because of retroactivity.

Since deductions are matters of legislative grace (*New Colonial Co. v. Helvering*, 292 U. S. 435, 440) and may be changed or eliminated altogether, the taxpayer's situation in this respect is no different from what it would be if the amendment had been enacted in 1940; surely it could not be contended that such a statute would be invalid. *Corliss v. Bowers*, 281 U. S. 376; *Reinecke v. Smith*, 289 U. S. 172; and *Burnet v. Wells*, 289 U. S. 670, involved provisions taxing the income of certain trusts to the settlor and sustained their application to trusts created when there was no such provision in the law. The situation in *Cooper v. United States*, 280 U. S. 409, was similar. *A fortiori*, a taxpayer has no vested right in a prospective deduction.

In view of the foregoing it is clear that the bad debts in question did not become worthless within the taxable year 1941, and that therefore the taxpayers are not entitled to a deduction therefor for that year under the provisions of Section 23 (k) (1) of the Internal Revenue Code, as amended, and Section 19.23 (k)-1 of Treasury Regulations 103, as amended.

CONCLUSION

The petition presents no conflict of decisions and shows no other reason for certiorari. The petition should therefore be denied.

Respectfully submitted.

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✓ DOUGLAS W. MCGREGOR,  
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✓ SEWALL KEY,  
✓ HELEN R. CARLOSS,  
✓ S. DEE HANSON,

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JULY 1946.

## APPENDIX

### Internal Revenue Code:

#### SEC. 23. DEDUCTIONS FROM GROSS INCOME [as originally enacted]

In computing net income there shall be allowed as deductions:

\* \* \* \* \*

#### (k) *Bad Debts.*—

(1) *General Rule.*—Debts ascertained to be worthless and charged off within the taxable year \* \* \*

\* \* \* \* \*

(26 U. S. C., Sec. 23.)

### Revenue Act of 1942, c. 619, 56 Stat. 798: <sup>5</sup>

#### SEC. 124. DEDUCTION FOR BAD DEBTS, ETC.

(a) *General Rule.*—Section 23 (k) (relating to bad debts and securities becoming worthless) is amended to read as follows:

#### “(k) *Bad Debts.*—

“(1) *General Rule.*—Debts which become worthless within the taxable year; \* \* \*

\* \* \* \* \*

#### (d) *Effective Date of Amendments.*—

The amendments made by this section adding the last sentence of section 23 (k) (1) and adding section 23 (k) (4) shall be effective only with respect to taxable years beginning after December 31, 1942; the amendment inserting section 23 (k) (5) and amendments related thereto shall be applicable only with respect to taxable years beginning after December 31, 1941; and the other amendments made by this

<sup>5</sup> Further amendments to Section 23 (k) (1) were made by Section 113 of the Revenue Act of 1943, c. 63, 58 Stat. 21 which are not material here.

section shall be effective with respect to taxable years beginning after December 31, 1938.

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (k)-1 [As amended by T. D. 5234, 1943 Cum. Bull. 119]. *Bad Debts.*—

(a) Bad debts may be treated in either of two ways—

(1) By a deduction from income in respect of debts which become worthless in whole or in part, or

\* \* \* \* \*

(b) If, from all the surrounding and attending circumstances, the Commissioner is satisfied that a debt is partially worthless, the amount which has become worthless during the taxable year shall be allowed as a deduction in computing net income. \* \* \* If a debt becomes wholly worthless during the taxable year, the amount thereof which has not been allowed as a deduction for any prior taxable year shall be allowed as a deduction for the taxable year. \* \* \* In determining whether a debt is worthless in whole or in part the Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. \* \* \*

Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bank-

ruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. \* \* \*

H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 44-45, 76:

3. *Treatment of Bad Debts.*—The bill makes substantial changes in the treatment of bad debts. These changes are designed to remove existing inequities and to improve the procedure through which bad-debt deductions are taken. It also makes certain the treatment which is to be accorded to the recovery of bad debts and previously paid taxes.

(A) *Elimination of charge-off requirements.*—In order to get a deduction for a bad debt under the present law two requirements must be met: (a) the debt must be ascertained to be worthless, and (b) it must be charged off during the taxable year.

These two requirements have caused considerable difficulty, particularly the requirement of a charge-off in cases where the taxpayer keeps inadequate records. In lieu of these two requirements, the bill substitutes the test of "debts which became worthless within the taxable year." Thus, whether or not the mechanics of the charge-off are fulfilled, the fact of worthlessness, which is the proper criterion, will prevail.

(B) *Longer statute of limitations for bad debts and worthless stock losses.*—Under the existing law, the taxpayer may be whipsawed out of a deduction for a bad debt because of the uncertainty as to the time at which the debt becomes worthless. Later evidence often discloses that present decisions as to the year in which a debt

becomes worthless are erroneous. For example, the taxpayer concludes that a debt has become bad and takes the deduction in that year, only to discover by later evidence that the debt actually became worthless three years previously. The statute of limitations having run on such previous year, this deduction is lost forever to the taxpayer. Conversely, where the debt actually became worthless in a year later than the year chosen by the taxpayer, the 3-year statute of limitations may operate against the Government.

To relieve this inequitable situation, the bill replaces the present 3-year statute of limitations in such cases with a 7-year statute, giving a considerably greater flexibility to the allowance of bad debt deductions in the proper year.

\* \* \* \* \*

*Section 119. Deduction for Bad Debts, Etc.*—Under present law ascertainment of worthlessness and charge-off on the books of the taxpayer during the taxable year are prerequisites for the allowance of a deduction for a bad debt. This section amends section 23 (k) of the Code to allow a deduction for a debt which becomes worthless during the taxable year regardless of the year in which the debt is ascertained to be worthless or charged off. A similar amendment is made to section 204 (c) (6) of the Code with respect to deductions for bad debts allowed insurance companies other than life or mutual. These amendments are made retroactive so as to apply to all taxable years beginning after December 31, 1938.

\* \* \* \* \*